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manufacturing
scheduling
planning

Jinspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6



SHIVA™

Annual Report 1996



ShivaSoft Inc.

Corporate Profile

ShivaSoft Inc. is a leading manufacturer of resource planning and scheduling systems. Its flagship product is the **SHIVA™** finite capacity resource planning system.

Annual General Meeting

The 1996 Annual General Meeting will be held on April 18, 1997 at 3:00 p.m. in the Mackenzie Room of the Centre Suite Hotel, 10222-102 Street, Edmonton, Alberta.

SHIVASOFT INC.

PRESIDENT'S MESSAGE

TO FELLOW SHAREHOLDERS:

On behalf of the Board of Directors, I am pleased to present our Annual Report for the year ended October 31, 1996.

OVERVIEW

During our second year of marketing our family of SHIVA™ software products, we made a great deal of progress:

- (a) Sales and profits grew as planned and we increased our penetration of a rapidly growing market.
- (b) Our North American customer base expanded and we made a major breakthrough in Europe.
- (c) Product development and enhancement continued with considerable user feedback.
- (d) Our Edmonton-based staff and the number of staff members "in the field" grew in line with our planned staffing needs for the forthcoming year. Placing rapid staff growth ahead of immediate needs is essential if we are to effectively meet the demand for our products while maintaining the quality and integrity of customer service for which we have become known and which gives us a competitive edge.

The objective of a corporation is to enhance shareholder value over the long term while safeguarding shareholder interests in the short term. For our company's purpose, three to five years is an appropriate time frame for measuring our success in enhancing long term shareholder value.

Our strong financial position permits management to focus exclusively on business-building activities (such as product development, marketing and customer service) free from financial constraints. It also maximizes our ability to fund research & development activities that will enhance the competitive strength, operational viability and profitability fundamental to creating long term shareholder value.

We expect strong continued growth in sales, profitability and market penetration and intend to at least double sales and improve operating margins in each of the next three years. This will be made possible by both external factors (such as market growth) and internal factors (which include product improvement and a growing recognition of

the merits of SHIVA™). Growth will also be due to competitive advantages that include:

- **momentum** - nothing succeeds like success;
- **the short payback period of the product** - often less than one year;
- **a reputation for product quality and customer service** that will attract new users and earn significant revenues from current users through service contracts and product updates;
- **user dialogue and feedback** that facilitates ongoing product enhancement and development;
- **a committed staff** with professional and personal growth potential; and,
- **strong financials** that leave management's hands free to single-mindedly build the company.

With a rapidly expanding market, a timely product, a growing reputation for quality and a supportive client base, one of the major challenges during the period ahead will be to continue to build our staff with a view to exploiting the opportunities and, in the process, create extraordinary shareholder value. Recruiting suitable new staff, particularly people with hands-on manufacturing systems or plant management experience, will be second only in priority to the on-going development and enhancement of our SHIVA™ products. To support the rapidly growing business, we must expand the corporate infrastructure.

PRODUCT DESCRIPTION

The SHIVA™ finite capacity scheduling software can be used by manufacturers as a strategic, tactical and/or "what if" planning tool. It provides users with the ability to decide rationally, in real time and on a plant or company-wide basis, what combination of resources - people, plant and equipment and materials - will achieve the lowest cost production and most desirable delivery schedules. The fact that it can be used as a stand-alone system or in conjunction with existing in-house business systems enhances its appeal.

The family of SHIVA™ products currently consists of SHIVA™ Standard, SHIVA™ Metals, SHIVA™ Batch Processing, SHIVA™ Make/Engineer to Order and SHIVA™ Assembly Line. They enable manufacturers to develop and implement production schedules that are practical, usable and realistic. The software helps to minimize downtime, bottlenecks, work-in-progress and inventory and yet maximizes the likelihood that finished goods will be available for shipment to customers exactly when required.

SUMMARY AND PROSPECTS FOR GROWTH

Most ShivaSoft Inc. customers use their SHIVA™ software as a production planning and scheduling system, but it also has built-in strategic planning capabilities. Those users who have had experience with SHIVA™ products for some time, are beginning to explore the strategic planning potential. This process will help to establish a reputation for SHIVA™ as a sophisticated corporate management and planning tool rather than just a manufacturing scheduling system and will significantly increase its market potential.

SHIVA™ software is a big ticket item. While its price may vary depending on customers' needs and preferences, it always runs into six figures. Despite its cost, demand is unlikely to be affected by the general economic cycle because :

- (a) its short payback period, typically less than one year;
- (b) its purchase can be justified on different grounds at different stages of the business cycle - to maximize production when the demand is strong and to reduce costs when it is weaker; and,
- (c) it is recognized as one of the key tools necessary to remain competitive in the marketplace.

STRATEGIES FOR GROWTH

MARKET POTENTIAL

Advanced Manufacturing Research, an industry consultant, recently forecasted that North America's Enterprise Resource Planning (ERP) market was growing at 40% annually from a US \$4 billion base. Furthermore, they predicted that the market sector of which finite capacity scheduling software is a component, was its "hottest segment" and would "grow from US \$92 million in 1996 to more than US \$630 million by the end of the decade".

Manufacturers face rapid technological change, shorter equipment life cycles and immense competitive pressures. To make the best use of their productive facilities and minimize downtime and rejection rates, they must overhaul their production management and scheduling systems. While some are discarding their own systems completely and installing a late 20th century system from scratch, a much larger group wants merely to upgrade existing systems (which in many cases are based on 1980's, if not 1970's, technology). Unlike many competing products, SHIVA™ can meet the objectives and specifications of both groups.

COMPANY POSITION

The market in which ShivaSoft Inc. operates is highly fragmented and no one company dominates. Only a tiny fraction of the 50,000 - 100,000 North American manufacturers who will benefit from implementing new production management and scheduling systems have so far completed this process. A growing number of these manufacturers are choosing SHIVA™. This has enabled ShivaSoft Inc. to be profitable from the outset in an industry where, generally speaking, "burn rates", rather than profits, are the key financial measure in many companies' early years. More importantly, the success of SHIVA™ has provided:

- (a) **the cash flow** to underwrite major marketing and staff recruitment and development efforts;
- (b) **the opportunity** to test and develop new products on the basis of user experience and, in the process, help to improve our competitive edge; and
- (c) **the critical mass of high profile users** who increase our credibility in the marketplace, by the use of our products and the willingness to provide references.

IMPLEMENTATION

Effective recruiting and personnel management will be of crucial importance to the successful implementation of the strategies. We must also manage a transition from being a company with a small staff working in close proximity to each other, to one with a rapidly expanding employee base that is scattered geographically, without losing the ability to have our staff operate effectively with limited day-to-day supervision.

To help promote our staff working as a team, regardless of their locations, sharing the same work ethic and going that extra mile in meeting customer's needs and wishes, we will emphasize:

- (a) **Centralized training and familiarization** - new employees will spend time in Edmonton.
- (b) **Company-wide workshops** - periodically, all staff will gather in one location to exchange ideas on the latest corporate and technical developments.
- (c) **Continuity** - the same staff member(s) will be involved in making the presentation, installing the system and servicing the needs of a customer.
- (d) **Dual responsibilities** - customer service staff will have industry and regional responsibility.
- (e) **Profit sharing** - the current policy of the Board is to provide reasonable compensation and have employees share in ShivaSoft Inc.'s overall profitability.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCE AND INFRASTRUCTURE

During the past year, revenues tripled as planned, to slightly over \$2 million, and after-tax income increased three and a half times, to almost \$400,000. Earnings per share (EPS) more than doubled, from \$0.01 to \$0.024. The number of shares outstanding was constant at 16,056,000. ShivaSoft Inc.'s working capital position improved to \$1.1 million on October 31, 1996, and shareholders' equity increased from \$1 million to \$1.4 million.

Relative to sales, the cost of sales declined on a year-over-year basis. In part, this reflected the economies realized as ShivaSoft Inc. grew. It also reflected a shift in expenditure from the Cost of Sales category to that of General and Administrative Expenses. Taken as a whole, however, the gross margin (Sales less Cost of Sales less General and Administrative Expenses) increased from 31.6% to 34.8%.

Our growing scale of operations necessitated an expansion of our Edmonton office. Fortunately, suitable space was available next door, which minimized the disruptive effect on day-to-day operations. Two new regional offices were opened up in North America, bringing the total number to four.

GENERAL OUTLOOK

The market for our product is expanding rapidly and our profile among manufacturers is growing. Therefore we are holding to the sales forecast made at the last Annual Meeting, of \$5 million in sales for the fiscal year, ending October 31, 1997.

Over our three to five year long-term horizon, we expect our gross margin to continue to improve due to economies of scale, a payoff on research & development and staff development expenditures and the growing importance of post-installation service and software support fee income as the number of SHIVA™ installations increases.

MARKETING

Among the year's most noteworthy events were the following:

- (a) Outokumpu Copper Oy, a Finnish manufacturer of copper products, entered into a corporate licensing agreement with ShivaSoft Inc., that will result in the SHIVA™ system being installed in all of its plants worldwide. This was our first sale outside North America and was especially pleasing because it resulted from its U.S. subsidiary's outstanding experience with the system.
- (b) CanPar Industries, a Vancouver-based particle board manufacturer, exporting high-quality door core products worldwide, had the SHIVA™ system installed in its Grand Forks, B.C. plant to be used for manufacturing scheduling and a host of other purposes. As our first client in the forest products industry, this sale could have far reaching implications.
- (c) Our first Annual User Conference was held in Edmonton for two days last August. ShivaSoft Inc. directors, management, staff and SHIVA™ users met to compare notes on their experience with the product, installation and post-installation problems and their solutions and plans and requirements for the future. A gratifyingly high proportion of users made the trip to Edmonton at their own expense, actively participated in the proceedings and concluded that it had been a worthwhile initiative and should be turned into an annual event.

STAFF MATTERS

By October 31, 1996, our staff had grown to eighteen, fourteen in Edmonton and four in the field from seven a year earlier. By October 31, 1997, we expect the numbers to increase further, to twenty-five and fifteen respectively.

To capitalize on the potential for creating shareholder value through the marketing of SHIVA™ software, we must expand staff levels beyond our immediate requirements. This will ensure that new staff members have complete understanding of and competence in our product and our commitment to customer service.

PROFIT SHARING

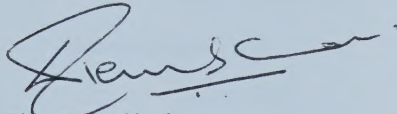
To foster team spirit and minimize fixed overhead, ShivaSoft Inc. created a profit sharing scheme for its employees. As noted earlier, the Board's policy in administering this plan is to provide reasonable compensation to ShivaSoft Inc.'s staff and have them share in the overall profitability. In view of the past year's results, the Board granted fifteen percent of the year's before-tax income for this purpose.

The Board is in the early stages of creating an employee share purchase plan. This will enable employees to invest in ShivaSoft Inc. and thereby further identify with the company's long term success.

CONCLUSION

Sales are on a strong upward path and margins are improving. ShivaSoft Inc. is maintaining a good relationship with its customers and staff is provided with incentives to help ensure continued growth and success. Everything is in place to promote long-term shareholder value.

Yours truly,

A handwritten signature in dark ink, appearing to read 'Dilip M. Kembhavi', with a horizontal line drawn underneath the signature.

Dilip M. Kembhavi
President & CEO

SHIVASOFT INC.

Financial Statements
For the year ended October 31, 1996

AUDITORS' REPORT

To the Directors of ShivaSoft Inc.:

We have audited the balance sheet of ShivaSoft Inc. as at October 31, 1996 and the statement of retained earnings (deficit), income and changes in financial position for the year then ended. These statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at October 31, 1996 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

December 6, 1996
Edmonton, Alberta

Gardiner Kaurani Andy Partners

CHARTERED ACCOUNTANTS

SHIVASOFT INC.

Balance Sheet As at October 31, 1996

ASSETS

	1996 \$	1995 \$
Current Assets:		
Cash	227,702	337,185
Term deposits	842,944	804,964
Accounts receivable	607,853	64,843
Prepaid expenses	38,896	-
Total current assets	1,717,395	1,206,992
Capital Assets, <i>Note 3</i>	147,249	67,231
Software Technology, <i>Note 4</i>	301,652	136,369
	2,166,296	1,410,592

LIABILITIES

Current Liabilities:		
Accounts payable, <i>Note 5</i>	417,752	307,373
Income taxes payable	209,364	26,038
Total current liabilities	627,116	333,411
Deferred Income Taxes	136,646	66,593
Total liabilities	763,762	400,004

SHAREHOLDER'S EQUITY

Share Capital, <i>Note 6</i>	870,465	870,465
Retained Earnings	532,069	140,123
Total shareholders' equity	1,402,534	1,010,588
	2,166,296	1,410,592

The accompanying notes are an integral part of these financial statements.

SHIVASOFT INC.

Statement of Retained Earnings (Deficit) For the Year Ended October 31, 1996

	1996	1995
	\$	\$
Balance, beginning of year	140,123	28,609
Net income	<u>391,946</u>	<u>111,514</u>
Balance, end of year	<u><u>532,069</u></u>	<u><u>140,123</u></u>

SIGNED ON BEHALF OF THE BOARD:

Director



Director



The accompanying notes are an integral part of these financial statements.

SHIVASOFT INC.

Statement of Income For the Year Ended October 31, 1996

	1996	1995
	\$	\$
Sales	2,024,317	647,929
Cost of Sales:		
Advertising and tradeshow	22,092	49,430
Amortization	35,387	12,311
Marketing	159,591	-
Royalties	56,484	19,663
Travel	221,174	92,290
Wages and benefits	625,725	191,931
	1,120,453	368,625
Gross Margin	903,864	279,304
General and Administrative Expenses:		
Business taxes and insurance	8,445	2,923
Investor relations	5,095	-
Loss on disposal of assets	-	1,458
Office	45,556	20,776
Professional fees	66,841	13,376
Provision for warranty reserve	46,100	24,505
Telephone and utilities	29,040	12,121
	201,077	75,159
Income before income taxes	702,787	204,145
Income taxes:		
Current	240,788	26,038
Deferred	70,053	66,593
	310,841	92,631
Net income	391,946	111,514

Earnings per common share, *Note 6*

The accompanying notes are an integral part of these financial statements.

SHIVASOFT INC.

Statement of Changes in Financial Position For the Year Ended October 31, 1996

	1996 \$	1995 \$
CASH PROVIDED FROM (USED IN):		
OPERATING ACTIVITIES:		
Net income	391,946	111,514
Items not affecting cash:		
Amortization	35,387	12,311
Amortization capitalized	5,469	-
Loss on disposal of assets	-	1,458
Deferred income taxes	70,053	66,593
	502,855	191,876
Changes to non-cash operating assets and liabilities:		
Accounts receivable	(543,010)	(6,856)
Prepaid expenses	(38,896)	-
Accounts payable	110,379	221,339
Income taxes payable	183,326	26,038
	214,654	432,397
FINANCING ACTIVITIES:		
Issuance of share capital	-	870,365
	-	870,365
INVESTMENT ACTIVITIES:		
Purchase of capital assets	(120,874)	(67,388)
Software development	(165,283)	(136,369)
	(286,157)	(203,747)
INCREASE (DECREASE) TO CASH RESOURCES	(71,503)	1,099,005
CASH RESOURCES, BEGINNING OF YEAR	1,142,149	43,144
CASH RESOURCES, END OF YEAR	1,070,646	1,142,149
Represented by:		
Cash	227,702	337,185
Term deposits	842,944	804,964
	1,070,646	1,142,149

The accompanying notes are an integral part of these financial statements.

SHIVASOFT INC.

Notes to the Financial Statements For the Year Ended October 31, 1996

1. INCORPORATION AND NATURE OF OPERATIONS:

The company was incorporated on May 25, 1987 and is in the business of development, marketing, sale and support of manufacturing planning and scheduling software.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) Revenue Recognition:

Revenue from sales of software license agreements is recognized when title passes to the customer, which generally coincides with the delivery and acceptance of the software products.

Extended support is offered for one year at an additional cost and is initially recorded as deferred revenue. The amount is recognized as income on a straight-line basis over the term of coverage.

(b) Warranties:

Software license agreements include a one-year warranty whereby ShivaSoft Inc. is required to provide assistance for customer support and maintenance of the software package. These costs are expensed as incurred and a further warranty provision of 5% of the current year's software license fees is recorded in anticipation of future costs from current year sales.

(c) Capital Assets and Amortization:

Capital assets are recorded at cost. Amortization is recorded on a declining balance basis using the following annual rates without residual values:

Furniture and equipment	20%
Computer equipment	30%
Automotive	30%
Computer software	100%

In the year of acquisition, amortization is calculated at one-half of the annual rates.

(d) Software Technology:

Software technology relating to the development of new software products, which meet specific criteria related to technical, market and financial feasibility, are capitalized and include wages, overhead, supplies and amortization. When sales commence, the costs are amortized on a straight line basis over a period of three years. Development costs are reviewed periodically for revisions to amortization rates or writedowns to net realizable value.

The carrying of software technology costs is assessed on an annual basis by analyzing the projected revenue and the continuing development costs to maintain the technology.

(e) Translation of Foreign Currencies:

Monetary assets and liabilities have been translated at the exchange rate in effect as at the balance sheet date. Revenues and expenses are translated at average rates of exchange during the year. Current gains and losses are reflected in income for the year.

SHIVASOFT INC.

Notes to the Financial Statements For the Year Ended October 31, 1996

(f) Income Taxes:

The Company follows the tax allocation method of providing for income taxes. Under this method, income taxes currently payable may differ from the total income tax provision for the year as a result of timing differences between recognition of revenues and expenditures for accounting and tax purposes. The tax effect of these timing differences is reflected in the accounts as deferred income taxes and the balance arises from:

- the excess of capital cost allowance for income tax purposes over amortization expense
- capital items expensed for income tax purposes
- warranty provisions recorded for accounting purposes but not for income tax purposes
- costs of share issuance expensed for income tax purposes.

3. CAPITAL ASSETS AND ACCUMULATED AMORTIZATION:

	1996		1995
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
Furniture and equipment	41,294	10,265	31,029
Computer equipment	125,069	39,935	85,134
Automotive	29,288	4,393	24,895
Computer software	20,845	14,654	6,191
	<u>216,496</u>	<u>69,247</u>	<u>147,249</u>
			<u>67,231</u>

4. SOFTWARE TECHNOLOGY

	1996	1995
	\$	\$
Software technology, at cost	<u>301,652</u>	<u>136,369</u>

SHIVASOFT INC.

Notes to the Financial Statements For the Year Ended October 31, 1996

5. ACCOUNTS PAYABLE

	1996	1995
	\$	\$
Wages payable	163,974	56,371
Warranty provision	70,605	24,505
Royalties payable, <i>Note 8(c)</i>	66,147	19,663
Trade payables	63,106	56,939
Deferred revenue	53,920	7,250
Share issuance costs payable	-	110,520
Advances payable	-	32,125
	<u>417,752</u>	<u>307,373</u>

6. SHARE CAPITAL:

(a) Authorized:		
Unlimited number of voting common shares	1996	1995
Unlimited number of non-voting preferred shares	\$	\$
Issued and Outstanding:		
16,056,000 common shares		
(1994 - 100 common shares)		
	<u>870,465</u>	<u>870,465</u>

(b) Unexercised Options:

The company has a stock option plan that permits the Board of Directors to grant to employees, officers and directors options from Treasury up to 1,600,000 common shares.

There are a total of 1,114,000 outstanding and unexercised options; 1,010,000 to employees, officers and directors of the company (with an exercise price ranging from \$0.25 to \$1.10, expiring on June 28, 1998 and October 31, 1999) and 104,000 to Global Securities Corporation (with an exercise price of \$0.25 each, expiring on September 25, 1997).

(c) Earnings per Common Share:

Earnings per common share is calculated on the basis of the weighted average number of common shares outstanding for the year which amounted to 16,056,000 (1995 - 9,964,265). Earnings per common share for the year ended October 31, 1996 is \$0.024 per share (1995 - \$0.01 per share).

SHIVASOFT INC.

Notes to the Financial Statements For the Year Ended October 31, 1996

7. INCOME TAXES:

The provision for income taxes varies from the amount which would be obtained by applying the combined Canadian federal and provincial income tax rate of 44.62% (1995 - 44.53%) as follows:

	1996		1995	
	\$	%	\$	%
Expected tax provision	313,584	44.26	90,901	44.53
Increase (decrease) in income taxes resulting from:				
Non-deductible expenses	1,243	0.18	1,730	0.85
Previously unrecognized income tax benefits	(3,986)	(0.57)	-	-
	<u>310,841</u>	44.23	<u>92,631</u>	45.38

8. COMMITMENTS:

(a) The company has entered into an agreement to lease real property for a period of forty-two months expiring in February, 2000. Minimum lease payments, based on estimated operating costs, over the next four years are estimated as follows:

	\$
1997	28,199
1998	28,199
1999	28,199
2000	<u>9,400</u>
	<u>93,997</u>

(b) The company entered into five year management agreements effective January 1, 1995 with two key employees who are also shareholders, for aggregate compensation of \$13,000 per month. The contracts include provisions for annual increments of 5% plus cost of living allowance on monthly salaries and bonuses to be determined from time to time by the Board of Directors.

(c) The company entered into an agreement with Desnet Systems, a partnership of two shareholders, to provide consulting and program development services for a period of three years from February 1, 1995. Desnet Systems will be paid 4% of software license fees, net of dealer commissions and discounts, on the sale of the Manufacturing Resource Scheduling System up to a cumulative maximum of \$200,000. During the year, the company has expensed \$56,484 (1995 - \$19,663) for a cumulative total of \$76,147 as consulting fees pursuant to this contract.

Head Office

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Facsimile: 403 423-0414

E-mail: sof@shivasoft.com

Officers

Dilip Kembhavi, President and CEO
Srinivas Netrakanti, Vice President, Development
Norm Bishop, Secretary

Directors

Dilip Kembhavi
Srinivas Netrakanti
Sunny Marche
William Hustler
Ian Dowdeswell

Shares Listed

Alberta Stock Exchange ("SOF")

Auditors

Gardiner Karbani Audy + Partners
Chartered Accountants
4107 - 99 Street, Edmonton, Alberta

Registrar and Transfer Agent

Montreal Trust Company of Canada
411-8th Avenue S.W., Calgary, Alberta

For Further Information Contact:

Dilip Kembhavi, President and CEO
Jim Hoffmeyer, Marketing Manager
Patrick Starr, Investor Relations



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